

Report of the auditor-general to the Free State Legislature and the council on the Nala Local Municipality

Report on the audit of the financial statements

Disclaimer of opinion

1. I was engaged to audit the financial statements of the Nala Local Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2019, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. I do not express an opinion on the financial statements of the municipality. Because of the significance of the matters described in the basis for disclaimer of opinion section of this auditor's report, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

Basis for disclaimer of opinion

Property, plant and equipment

3. I was unable to obtain sufficient appropriate audit evidence that the municipality had recognised all property, plant and equipment as the asset register submitted for audit did not contain information on the location (GPS co-ordinates) of the assets and due to the lack of sufficient reconciliations between the asset register and the title deeds of its properties. I could not confirm property, plant and equipment by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to property, plant and equipment stated at R1 169 202 611 (2018: R1 206 427 979) in note 8 to the financial statements.
4. The municipality did not recognise items of property, plant and equipment in accordance with GRAP 17, *Property, plant and equipment* as it did not ensure that properties controlled by the municipality were recognised as property, plant and equipment. The municipality did not review the residual value and useful life of property, plant and equipment in accordance with GRAP 17, *Property, plant and equipment*. As a result, property, plant and equipment with a cost of R27 982 744 had a zero net carrying amount while still being in use. Additionally, while vacant land held for capital appreciation was disclosed as property, plant and equipment instead of investment property. Consequently, property, plant and equipment was overstated by R75 414 099. There was also a resultant impact on investment property, depreciation, the surplus for the period and on the accumulated surplus.

Payables from exchange transactions

5. I was unable to obtain sufficient appropriate audit evidence for payables from exchange transactions due to the poor status of the accounting records as the municipality was unable to provide creditor statements. I could not confirm the payables from exchange transactions by alternative means. Consequently, I was unable to determine whether any adjustments were

necessary to trade and other payables from exchange transactions stated at R523 579 504 (2018: R421 120 392) in note 11 to the financial statements.

Service charges

6. The municipality did not recognise revenue from service charges in accordance with GRAP 9, *Revenue from exchange transactions*. Services were levied at the incorrect tariffs, and an unexplained difference in unmetered consumption resulting in service charges being overstated by R14 083 851 as stated in note 17 to the financial statements. There was also a resultant impact on receivables from exchange transactions, the surplus for the period and the accumulated surplus.

Provisions

7. The municipality did not recognise its environmental rehabilitation provision in accordance with GRAP 19, *Provisions, contingent liabilities and contingent assets*. The rehabilitation provision was based on the entire landfill site surface area and not only the contaminated areas as at the reporting date. I was unable to determine the full extent of the overstatement of the provision for environmental rehabilitation stated at R11 627 974 (2018: R10 659 065) in note 15 to the financial statement as it was impracticable to do so.

Receivables from exchange transactions

8. The municipality did not in note 3 to the financial statements recognise receivables from exchange transactions in accordance with GRAP 104, *Financial instruments*. The municipality incorrectly included a provision for impairment on national and provisional government entities, while differences were identified between the debtors' age analysis, financial statements, unmetered consumption schedule and other receivables in the financial statements, resulting in receivables from exchange transactions being understated by R11 179 090. There was also a resultant impact on the impairment loss, the surplus for the period and on the accumulated surplus.

Contracted services

9. I was unable to obtain sufficient appropriate audit evidence that goods were received for all contracted services recognised as well as transactions processed due to the status of the accounting records. I was unable to confirm contracted services by alternative means. Consequently, I was unable to determine whether any adjustment was necessary to contracted services stated at R54 107 324 in note 28 to the financial statements. Furthermore, the municipality did not present contracted services based on the nature of the underlying transactions in accordance with GRAP 1, *Presentation Of Financial Statements*. The municipality included a line items for Specialist Services and Services Rendered which did not agree to the underlying nature of the transactions included in the amount and items of general expenditure were also incorrectly included in contracted services. I was unable to determine the full extent of the misstatement of contracted services as it was impracticable to do so.

General expenditure

10. During 2018, the municipality did not recognise all its general expenses as in terms of GRAP 1, *Presentation of financial statements*, due to sufficient controls not being implemented to ensure that general expenses were recorded and accounted for in the correct financial year.

Consequently, general expenses and trade payables were overstated by R13 801 070 in note 30 to the financial statement. My audit opinion on the financial statements for the period ended 30 June 2018 was modified accordingly. My opinion on the current year financial statements was also modified because of the possible effect of this matter on the comparability of the general expenses for the current period.

Accumulated surplus

11. The municipality did not prepare the financial statements in accordance with GRAP 1, *Presentation of Financial Statements*. The total assets did not agree to total liabilities and accumulated reserves. Consequently, accumulated surplus was misstated by R34 041 258.

Statement of comparison of budget and actual amounts

12. The municipality did not prepare the statement of comparison of budget and actual amounts in accordance with GRAP 24, *Presentation of Budget Information in Financial Statements*. I identified material misstatements between the final budget amounts disclosed and the final approved budget. I was unable to determine the full extent of the misstatement as it was impracticable to do so.

Cash flow statement

13. The municipality did not prepare the cash flow statement in accordance with GRAP 2, *Cash flow statements*. The calculation of net cash flows from operating activities were materially misstated due to unexplained differences in the cash flow calculations. I was unable to determine the full extent of the misstatement as it was impracticable to do so.

Material uncertainty relating to going concern

14. I draw attention to the matter below. My opinion is not modified in respect of this matter.
15. Note 38 to the financial statements indicates that the municipality incurred a net loss of R120 014 938 during the year ended 30 June 2019 and, as of that date, the municipality's current liabilities exceed its current assets. These events or conditions, along with other matters as set forth in note 38, indicate that a material uncertainty exists that may cast significant doubt on the municipality's ability to continue as a going concern.

Emphasis of matter

16. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Irregular expenditure

17. As disclosed in note 41 to the financial statements, the municipality incurred irregular expenditure of R28 738 022 (2018: R45 332 334), mainly due to non-compliance with supply chain management (SCM) requirements.

Fruitless and wasteful expenditure

18. As disclosed in note 40 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R17 491 337 (2018: R5 085 101), mainly due to interest and penalties on accounts that were not paid timeously.

Restatement of corresponding figures

19. As disclosed in note 36 to the financial statements, the corresponding figures for 30 June 2018 had been restated as a result of errors in the financial statements of the municipality at, and for the year ended, 30 June 2019.

Material uncertainty relating to claims against the municipality

20. With reference to note 34 to the financial statements, the municipality is the defendant in various claims against the municipality. The municipality is opposing these claims. The ultimate outcome of these matters could not be determined and no provision for any liabilities that may result was made in the financial statements.

Material losses

21. As disclosed in note 44 to the financial statements, material water losses of R18 124 682 (2018: R16 084 525) were incurred, which represents 38,29% (2018: 36,85%) of the total water purchased and this was mainly due to leakages.

Material impairments

22. As disclosed in note 3 and 4 to the financial statements, receivables from exchange and non-exchange transactions were impaired by R537 680 177 (2018: R473 668 289) and R36 228 491 (2018: R33 361 952) respectively.

Other matter

23. I draw attention to the matter below. My opinion is not modified in respect of these matters.

Unaudited disclosure notes

24. In terms of section 125(2)(e) of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA), the municipality is required to disclose particulars of non-compliance with the MFMA in the financial statements. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion on it.

Responsibilities of the accounting officer for the financial statements

25. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the MFMA and the Division of Revenue Act of South Africa, 2018 (Act No. 1 of 2018) (Dora), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

26. In preparing the financial statements, the accounting officer is responsible for assessing the Nala Local Municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the financial statements

27. My responsibility is to conduct an audit of the financial statements in accordance with the International Standards on Auditing and to issue an auditor's report. However, because of the matters described in the basis for disclaimer of opinion section of this auditor's report, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.
28. I am independent of the municipality in accordance with sections 290 and 291 of the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants* and parts 1 and 3 of the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA codes) as well as the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA codes.

Report on the audit of the annual performance report

Introduction and scope

29. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for the selected key performance areas (KPAs) presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.
30. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators/measures included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.
31. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected KPA presented in the annual performance report of the municipality for the year ended 30 June 2019:

| Key Performance Area | Pages in the annual performance report |
|-----------------------------|---|
| Basic service delivery | x – x |

32. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
33. The material findings in respect of the usefulness and reliability of the selected KPA are as follows:

KPA – Basic service delivery

TL 1: Number of formal households that receive piped water (credit and prepaid water) that is connected to the municipal water infrastructure network as at 30 June 2019.

34. The target approved in the service delivery implementation plan was 17 243. However, the target reported in the annual performance report was 17 500.

TL:5 % of HH that are registered as indigent and receiving free basic water

35. I was unable to obtain sufficient appropriate audit evidence to support the measures taken to improve performance against target 45% as reported in the annual performance report. This was due to limitations placed on the scope of my work and. I was unable to confirm the reported measures taken by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported measures taken to improve performance.

TL 5: Percentage of households that are registered as indigent and receiving free basic services

36. There was no clear and logical link between the indicator and the strategic objective to which it relates. The indicator focused on households that are registered as indigent and receiving free basic services, while the strategic objective aimed to ensure that all registered indigents have access to free basic water.

Various indicators

37. The method of calculation for achieving the planned indicator was not clearly defined in the following instances:

| Indicator | Calculation |
|---|---|
| TL 5: % of HH that are registered as indigent and receiving free basic services | Number of HH registered as indigent receiving free basic services divided by number of HH |

| | |
|---|---|
| TL 12: % of a municipality's capital budget actually spent on capital projects identified for a particular financial year in terms of the municipality's integrated development plan (MFMA Circular 71) | Actual Capital Expenditure/ Budget Capital Expenditure x 100 |
| TL 38: To reduce water loss in distribution to 10%. (MFMA Circular 71) | (Number of Kiloliters Water Purchased or Purified - Number of Kilolitres Water Sold) / Number of Kiloliters Water Purchased or Purified x 100 |
| TL 39: % of the roads and storm water maintenance budget spent by the end of June. | Actual expenditure on maintenance divided by the total approved maintenance budget. |
| TL 40: % Electricity distribution losses.(KWH billed/KWH acquired) (MFMA Circular 71) | (Number of Electricity Units Purchased and / or Generated - Number of Electricity Units Sold) / Number of Electricity Units Purchased and / or Generated) x 100 |

Various indicators

38. The reported achievement in the annual performance report did not agree to the supporting evidence provided for the indicators listed below. The supporting evidence provided indicated that the achievements of these indicators were as follows:

| Indicator | Reported achievement | Audited value |
|--|----------------------|---------------|
| % of HH that are registered as indigent and receiving free basic services | 42.28% | 31% |
| % of a municipality's capital budget actually spent on capital projects identified for a particular financial year in terms of the municipality's integrated development plan (MFMA Circular 71) | 85% | 74% |
| % of the roads and storm water maintenance budget spent by the end of June | 100% | 38% |

Other matters

39. I draw attention to the matters below:

Achievement of planned targets

40. Refer to the annual performance report on pages xx to xx for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information in paragraph 34 to 38 of this report.

Adjustment of material misstatements

41. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of the KPA – basic service delivery. As management subsequently corrected only some of the

misstatements, I raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are reported above.

Report on the audit of compliance with legislation

Introduction and scope

42. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.
43. The material findings on compliance with specific matters in key legislations are as follows:

Annual financial statements, performance report and annual report

44. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of non-current assets, current assets, revenue, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and/or the supporting records provided, but the uncorrected material misstatements and/ or supporting records that couldss not be provided resulted in the financial statements receiving a disclaimer of opinion.
45. I was unable to obtain sufficient appropriate audit evidence that the 2017-18 annual report had been made public after being tabled in the council, as required by section 127(5)(a) of the MFMA.
46. I was unable to obtain sufficient appropriate audit evidence that the local community had been invited to submit representations in connection with the 2017-18 annual report, as required by section 127(5)(a) of the MFMA.
47. I was unable to obtain sufficient appropriate audit evidence that the council adopted an oversight report containing the council's comments on the annual report no later than nine months after the end of the financial year, as required by section 129(1) of the MFMA.
48. I was unable to obtain sufficient appropriate audit evidence that the oversight report adopted by the council on the 2017-18 annual report had been made public, as required by section 129(3) of the MFMA.

Expenditure management

49. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
50. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA. The majority of the disclosed irregular expenditure was caused by non-compliance with SCM requirements.
51. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R17 491 337, as disclosed in note 40 to the annual financial statements, in contravention of

section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful expenditure was mainly due to interest and penalties on accounts that were not paid timeously.

Revenue management

52. An adequate management, accounting and information system was not in place to account for debtors and revenue, as required by section 64(2)(e) of the MFMA.

An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

Asset management

53. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
54. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

Strategic planning and monitoring

55. Performance targets were not set for each of the KPAs for the financial year, as required by section 41(1)(b) of the Municipal Systems Act, 2000 (Act No.32 of 2000) (MSA) and municipal planning and performance management regulation 12(1).
56. A mid-year performance assessment was not performed, as required by section 72(1)(a)(ii) of the MFMA.
57. Amendments to the Intergrated Development Plan (IDP) were made without making the proposed amendments available for public comment, as required by section 34(b) of the MSA and municipal planning and performance management reg 3(4)(b) and 15(1)(a)(ii).
58. Amendments to the IDP were made without consultation with the district municipality, as required by municipal planning and performance management reg 3(6)(a).
59. A performance management system was not adopted, as required by municipal planning and performance management regulation 8.
60. The performance management system and related controls were inadequate as it did not describe how the performance reporting and improvement processes should be conducted, as required by municipal planning and performance management regulation 7(1).

Procurement and contract management

61. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of SCM regulation 17(a) and (c). Similar non-compliance was also reported in the prior year.
62. Quotations were accepted from bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c). Similar non-compliance was also reported in the prior year.

63. Some of the goods and services with a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).
64. Bid specifications for some of the tenders were drafted in a biased manner and did not allow all potential suppliers to offer their goods or services, in contravention of SCM regulation 27(2)(a). This non-compliance was identified in the procurement processes for the construction of 1km of paved road.
65. Sufficient appropriate audit evidence could not be obtained that contract were only awarded to providers whose tax matters had been declared by the South African Revenue Service to be in order, as required by SCM regulation 43. Similar non-compliance was also reported in the prior year.
66. Some of the contracts and quotations were awarded to bidders based on pre-qualification criteria that were not stipulated and/or differed from those stipulated in the original invitation for bidding and quotations, in contravention of the 2017 preferential procurement regulation 4(1) and 4(2).
67. Contracts were extended or modified without the approval of a properly delegated official, in contravention of SCM regulation 5. Similar non-compliance was also reported in the prior year.
68. Awards were made to providers who were in the service of other state institutions in contravention of section 112(j) of the MFMA and SCM regulation 44.
69. Persons in service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, in contravention of SCM regulation 46(2)(e).
70. Some of the contracts were awarded through a competitive bidding processes that were not adjudicated by the bid adjudication committee.
71. The preference point system was not applied for some of the procurement of goods and services above R30 000 as required by section 2(a) of the Preferential Procurement Policy Framework Act.

Human resource management

72. I was unable to obtain sufficient appropriate audit evidence that appropriate systems and procedures to monitor, measure and evaluate performance of staff had been developed and adopted, as required by section 67(1)(d) of the MSA.
73. I was unable to obtain sufficient appropriate audit evidence that the municipal manager and senior managers had signed performance agreements within the prescribed period, as required by section 57(2)(a) of the MSA.

Consequence managements

74. Previous year unauthorised expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) of the MFMA.

75. Some of the irregular expenditure incurred in the previous years by the municipality were not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.

76. Some of the fruitless and wasteful expenditure incurred in the previous years by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.

Other information

77. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report and the selected KPA presented in the annual performance report that has been specifically reported in this auditor's report.
78. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
79. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected KPA presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
80. As a result of the disclaimer of opinion expressed on the financial statements, I do not conclude on material misstatements of the other information relating to the financial statements. If, based on the work I have performed relating to the audit of performance information and compliance with legislation, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

Internal control deficiencies

81. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the disclaimer of opinion, findings on the annual performance report and the findings on compliance with legislation included in this report.
82. Management failed to implement appropriate follow-up actions and preventative controls that adequately addressed the root causes of reported findings. No consequence management was in place to hold individuals accountable for the non-performance of internal control responsibilities or to establish and communicate adequate policies and procedures to enable and support the understanding and execution of internal control objectives, processes and responsibilities. Furthermore, an effective human resource plan had not been established to identify and address organisational staff needs including filling of the vacant senior management positions.
83. Management did not regularly review and monitor compliance with laws and regulations and internally designed policies and procedures. This resulted in significant non-compliance issues

that could have been prevented. The internal audit unit and the audit committee did not function properly, resulting in various internal control weaknesses in financial and performance reporting not being detected and corrected timeously. In addition, a risk assessment was not performed during the year.

Other reports

84. I draw attention to the following engagements conducted by various parties that had, or could have, an impact on the matters reported in the municipality's financial statements, reported performance information, compliance with applicable legislation and other related matters. These reports did not form part of my opinion on the financial statements or my findings on the reported performance information or compliance with legislation.
85. The National Prosecuting Authority is investigating findings relating to procurement as contained in the report of the Public Protector of South Africa issued during September 2010. The investigation was still ongoing at the reporting date.

Auditor -General

Bloemfontein

30 November 2019



Auditing to build public confidence